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No. 256.

Supreme Court of the United States

THE MERCHANTS NATIONAL BANK OF CINCINNATI,
Plaintiff in Error,

versus

THERESA J. WEHRMANN, Executrix of William F. Wehrmann, Deceased, et al,
Defendants in Error.

ON ERROR TO THE SUPREME COURT OF OHIO.

Brief for Plaintiff in Error.

W. C. HERRON,
Of Counsel for Plaintiff in Error.

THE COURT INDEX PRESS, Law Printers, 806 Main Street, Cincinnati, Ohio.

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OCTOBER TERM, 1905.

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THE RECORD.

This cause began by petition filed July 2, 1897, in the Common Pleas Court of Hamilton County, Ohio, by William F. Wehrmann against Frank B. McFarlan and a number of other persons and corporations, including the plaintiff in error, which petition is found on pages 16 to 19 of the Record.

In this petition the plaintiff alleged that the various defendants, including the plaintiff in error, were partners

doing business in the county of Hamilton and state of Ohio under the name of the Elsmere Syndicate; that said syndicate was formed on the 13th day of February, 1889, for the purpose of dealing in a large tract of land contiguous to the city of Cincinnati; that said syndicate carried on business for some years and finally became insolvent; that the plaintiff in error, at the time of said insolvency, was the owner of nine shares in said syndicate. The petition then prayed that the syndicate should be dissolved, that an accounting should be made between the partners, that a receiver should be appointed, and that its assets should be applied to the payments of its debts.

The case was referred to a master, whose report will be found from pages 20 to 26 of the Record, and the master found that the syndicate was a partnership and that the plaintiff in error was the owner of nine shares therein, and his report was confirmed by the Common Pleas Court of Hamilton County.

Subsequently, an appeal was taken to the Circuit Court of Hamilton County, which court rendered judgment on the 5th day of May, 1902, which judgment will be found on pages 37 to 45 of the Record. That court again found that the said syndicate was a partnership, that the plaintiff in error was the owner of nine shares, and liable as a partner for the debts of said syndicate. To that judgment a petition in error was taken to the Supreme Court of Ohio, and the opinion of that court will be found reported in the case of *The Merchants National Bank* v. *Wehrmann*, 69 O. S., 160. That court decided that the Elsmere Syndicate was a partnership and that the plaintiff in error became the owner of nine shares in said partnership; but that the plaintiff in error had no power, under the bank-

ing laws of the United States, to become a member of a partnership, and that, therefore, the legal effect of its ownership of said shares was to make it "a part owner in severalty of the property then owned by the partnership, and as such liable for nine-fortieth parts of the debts and expenses incurred in purchasing, holding, handling, managing, improving and disposing of said property." The case was remanded to the circuit court with instructions to determine the assets and liabilities of the Elsmere Syndicate, and to render a judgment against the plaintiff in error for nine-fortieths of the deficiency between said assets and liabilities. This judgment will be found on page 48 of the Record and was entered October 27, 1903.

The cause then went back to the Circuit Court of Hamilton County, where a judgment was rendered against the plaintiff in error for nine-fortieths of said deficiency, amounting to $9,167.13. The second judgment of the circuit court will be found on pages 57 to 63 of the Record. The case was then taken to the Supreme Court of Ohio, which affirmed the judgment of the circuit court without report. From this final judgment of the Supreme Court of Ohio, this petition in error is prosecuted.

THE FACTS.

The Elsmere Syndicate was organized by an agreement entered into January 25, 1889, which will be found on page 34 of the Record (Exhibit 4). By this agreement it was provided that the signers thereof should form a syndicate with a capital stock of $320,000, divided into forty shares, each party to take the number of shares set opposite to his signature to said agreement. That said

capital stock was to be used to purchase a tract of land in Hamilton county, which said land was to be improved and developed and finally sold. The fifth clause of the agreement provided as follows:

> "Fifth. After the cost of land, including the cost of making streets, advertising, etc., etc., shall have been paid out of the receipts for the sale of lots, then the receipts shall be considered net profits, and shall be divided among the shareholders equally, share and share alike."

The plaintiff in error was not a party to this agreement, but one F. B. McFarlan subscribed for several shares under said agreement. The real estate was purchased and conveyed to three persons as trustees, the conveyance appearing on page 30 of the Record (Exhibit 2). And, about the same time, a declaration of trust was executed, which appears on page 31 of the Record (Exhibit 3), between the various signers of the agreement and the three trustees, by which it is stated that the trustees are the owners of the said real estate, and of all the rents, issues and profits thereof, and have power to sell the same without any obligation upon the part of the purchasers to look to the application of the purchase money, and that the proceeds of sale, and the rents, issues and profits of the real estate are to be held upon the trust to pay all the expenses of surveying, sub-dividing and improving and selling the property; to pay the purchase money for the property as it falls due, and to pay the balance of the money realized from sales, etc., proportionately to the holders of certificates in the Elsmere Syndicate. About the same time the syndicate organized, and issued certificates to the various signers of the agreement, an example of which appears

on page 35 of the Record (Exhibit 6*a*), wherein it is recited:

> "This is to certify that .....is the owner of a one-fortieth interest in the Elsmere Syndicate; transferable in person or by attorney upon the books of the syndicate at its office in the city of Cincinnati upon the surrender of this certificate.
>
> "Witness our hands this ..... day of ....., ...
>
> "....,
>
> "....,
>
> "....,
>
> "Trustees."

By-laws were drawn up which appear on pages 36 and 37 of the Record, wherein the trustees are given expressly all the powers formerly given them by the declaration of trust, and also the power of general supervision over the affairs of the syndicate at a regular salary. The syndicate thereupon began the development of the property, and in so doing issued title bonds, an example of which appears on page 49 of the Record (Exhibit 58); warranty deeds, examples of which appear on page 48 of the Record (Exhibit 56), and page 51 of the Record (Exhibit 63); mortgages, an example of which appears on page 56 of the Record; and issued promissory notes, examples of which appear on pages 52 of the Record (Exhibit 68), and 53 of the Record (Exhibit 74). Every one of these obligations was issued by the trustees of the Elsmere Syndicate, and none of the persons who signed said agreement were parties to any of them.

On January 15, 1892, one Frank B. McFarlan, who had subscribed for certain shares under the original agree-

ment and had subsequently acquired others, so that, at that time, he claimed to be the owner of nine shares in said syndicate, being heavily indebted to the plaintiff in error, transferred said nine shares to W. W. Brown, trustee, and said shares stood in the name of said Brown, trustee, at the time of the insolvency of said syndicate. W. W. Brown was the cashier of the plaintiff in error, and, as the Supreme Court of Ohio has found that the effect of this transfer to him as trustee was to make the bank the owner, *de facto*, of these shares, that question is not open to further argument in this court, and it must be, therefore, assumed that on January 15, 1892, the plaintiff in error, in order to secure and save a pre-existing indebtedness, became the owner *de facto* of nine shares in the said Elsmere Syndicate.

THE LAW.

The question, therefore, now before this court is whether or not the plaintiff in error had power to take title to these shares in any way, so as to render itself liable for any part of the indebtedness of the Elsmere Syndicate. This point is raised by the first assignment of error, page 5 of the Record, which is:

> "First. The court erred in its construction of the banking laws of the United States, and specifically in its construction of Sections 5136 and 5137 of the Revised Statutes of the United States, relating to national banks, and in holding that the plaintiff in error, a corporation organized under said banking laws of the United States, had power, under such laws, and specifically under said Sections 5136 and 5137, to become liable for any part of the indebtedness of the Els-

mere Syndicate, a partnership dealing in real estate."

It may be noted, at the outset, that this objection was taken by the bank in the common pleas court, and has been raised in the proper manner in every court since (see Record 45; Record 47; Record 63; Record 64).

(*a*). It will undoubtedly be urged by counsel for the defendants in error, that no federal question is raised in this case, since the Supreme Court of Ohio decided the only federal question involved in favor of the plaintiff in error.

It is submitted, however, that this point is directly governed by the decision of this court in *The California Bank* v. *Kennedy*, 167 U. S., 362. The decision of the Supreme Court of California in that case is reported in *The Bank* v. *Kennedy*, 101 Cal., 495. The Supreme Court of California there held, that while a national bank had probably no power to take stock in a savings bank as an investment, it did have power to take such stock for some purposes, *e. g.*, as collateral security for a pre-existing debt, and that, having such power for some purposes, it was estopped, as against innocent third persons, to set up that it had not taken the stock for lawful purposes in that case. This court held that that decision of the Supreme Court of California raised a federal question, and in its decision this court went into the whole question of estoppel as well as of *ultra vires*, and held that the entire legal effect, under the statutes of the United States, of what the bank did, and its general liability under such statutes as against third persons, was a federal question reviewable in this court.

So, in the case at bar, what the Supreme Court of Ohio did, as indicated by a careful analysis of its opinion in the 69th Ohio State, 160, was to hold that the bank had no power to take these shares as a partner, but that it did have power to take the title to them for some purposes, and that "the legal effect" of its taking the title was to make it a part owner of the real estate of the syndicate, and as such liable for a proportion of the expenses incurred in developing that real estate.

The Supreme Court of Ohio distinctly held that the Elsmere Syndicate was a partnership and that the plaintiff in error took title to nine shares as a partner, just as, in the California bank case, the Supreme Court of California did not deny that, in fact, the California bank took the shares in question as an investment purely. The Supreme Court of Ohio held, however, that, as against third parties, the plaintiff in error must be taken to have acquired an interest in the real estate of the syndicate, and to be liable as a part owner thereof; just as the Supreme Court of California held that, as against third persons, the California Bank must be taken to have acquired the shares as collateral for a pre-existing indebtedness, and was estopped to set up the contrary. The nature of the ruling, therefore, in the California Bank case, and in the case at bar appear to be precisely the same upon principle, and to involve precisely the same federal question.

That the above is a true analysis of the decision of the Supreme Court of Ohio in 69 O. S., 160, appears clearly from the opinion of the court on page 169, where it is said:

> "The Merchants National Bank of Cincinnati is a corporation organized under the national

banking laws of the United States, and the Elsmere Syndicate was a partnership consisting of forty shares, each partner holding one or more shares, and each share evidenced by a certificate as shown in the foregoing statement of facts, and which certificates were transferable on the books of the syndicate, and such transfers were intended to make the transferee a partner in the syndicate instead of the transferor, without a dissolution of the partnership.

"The circuit court finds that the bank became owner by transfer of nine shares of this syndicate or partnership, which shares were taken by the bank to secure the payment of a large indebtedness owing to said bank for loans by it made to one of its customers in the usual course of business."

Continuing then to hold, at length, that the bank had no power under the national banking laws to take these shares as a partner, the court continued, on page 175, as follows:

"The bank having become the owner of these nine shares, and not having the power to become a partner, it became in legal effect a part owner of the property of the syndicate, which ownership was in its nature several, and the bank, * * * became and is liable for its share of the expenses of purchasing, managing, handling, holding, improving, and disposing of the property."

The holding was, therefore, that the bank intended to become a partner, and that the transfer of the shares to it would have made it a partner, had not the defense of *ultra vires* been interposed; that the defense of *ultra vires* was sufficient to exclude the bank from becoming a part-

ner, as it had intended to do, or to become liable as such partner, but that the defense was not sufficient to exclude the incidental legal effect of making the bank a part owner of the real estate, a position it never intended to occupy, and liable as such for its proportion of the liabilities of the syndicate. The federal question, therefore, clearly raised on the Record is as to the effect of the defense of *ultra vires* when pleaded by a national bank; whether that defense relieves it entirely from all liability, or whether liability may be placed upon it in another form so as to reach the same result. It is submitted, therefore, that the question raised in this case is precisely the same as the question raised in the California Bank case, and that the decision of this court upon the motion to dismiss in the California Bank case is decisive in this, so far as the existence of a federal question is concerned.

(*b*). Coming to the question of the merits of the case, the first question is whether the Supreme Court of Ohio gave to the defense of *ultra vires*, raised under the banking laws of the United States, its true and proper effect. Assuming that the bank intended to become a partner in the syndicate, as the Supreme Court of Ohio has held it did, and assuming that it had not the power under the banking laws of the United States to become a partner, can it be made liable in any other way by reason of its title to the nine shares in the syndicate?

This point, again, is distinctly concluded by the decision in *The California Bank* v. *Kennedy*. This court in that case, following a line of its own decisions, the most important of which is *The Central Transportation Company* v. *Pullman Palace Car Company*, 139 U. S., 24, held that a contract which is *ultra vires* is not voidable merely,

but absolutely void, and can produce no legal effect whatsoever either by way of acquiring title or by reason of any estoppel. A contract which is *ultra vires* is as though it had never been made, in so far as a party raising the defense is concerned. The decision in *The California Bank* v. *Kennedy* clearly intimates that no title passes under such an *ultra vires* transaction at all, and that *e. g.*, the California Bank acquired no title whatever to the shares of stock which it had no power to take, and could not, therefore, be made liable upon the supposition that it had acquired the title for any purpose or in any manner whatsoever. This court said, on page 369:

> "Stock so acquired creates no liability to the creditors of the corporation whose stock was attempted to be transferred."

The language "no liability" and "whose stock was attempted to be transferred," indicates clearly that this court conceived of the whole transaction as absolutely void, that the transfer of the stock to the California Bank was without any legal effect whatsoever, and could raise no liability of any kind, or to any extent, against the bank in favor of the creditors of the corporation.

The fallacy of the reasoning of the Supreme Court of Ohio in this case is obvious, and involves a begging of the whole question involved. After stating that the bank became the owner *de facto* of these shares, and after holding that it had no power to take these shares as a partner, it assumes, in the conclusion of its opinion, without any reasoning or citation of authority, that it could take the title to these shares for some other purpose, which the parties had never contemplated, and could, in law, make

itself liable in that way. It, therefore, assumes the whole question in issue. It decides (directly contrary to the decisions of this court), that an *ultra vires* contract is not entirely void, that title may pass under it, that a person acquiring shares under an *ultra vires* contract becomes the owner in law of them for some purposes, and may be liable to some extent as such owner. This court held directly the contrary in the California Bank case; and, applying the reasoning of that case to the case at bar, the conclusion is irresistible, that if the bank had no power to take the shares as partner, it could not make itself liable at all. It would not become the owner of the shares *de jure*, and, therefore, no consequential liability as such owner could be imposed upon it. The contract of purchase of the shares would be null and void, as though it never had been made; no title to the shares would pass to the bank, and no "legal effect" can be attributed to the transfer at all.

It is hardly necessary to call the court's attention to the fact that the decision of the Supreme Court of Ohio results in an anomalous and novel situation. There can be no question that the Elsmere Syndicate was a partnership. The facts set forth in the earlier part of this brief show this clearly, and the provisions of the fifth paragraph of the agreement are specific upon that point. The title to the real estate was in the trustees, and not in the members of the syndicate, and the entire business of the syndicate was carried on by these trustees as indicated in the obligations issued by them and referred to hereinbefore. The certificates issued expressly give an interest merely in the Elsmere Syndicate. They do not purport to give any interest in land, or any title to a part interest in the

land, but simply to give an interest in the net profits resulting from the disposition of the land. The result contemplated by the parties and actually attained by the papers they executed, was the creation of a partnership dealing in real estate, whose interests were managed by three trustees, elected by the partners in whose name was the legal title to all of the real estate. The decision of the Supreme Court of Ohio, going directly contrary to the intention of the parties, disregarding all of these agreements, deeds, certificates, etc., results in the creation of a partnership as to thirty-one-fortieths interest in the syndicate, the holders of which interest are *inter se* partners, controlled by three trustees, and a nine-fortieths interest in the real estate itself, held by the plaintiff in error. No such legal relationship was ever heard of before, no such relation was contemplated by the parties, and the result can not but suggest a compromise upon the part of the Supreme Court of Ohio in order to make the plaintiff in error liable in some way. The doctrine of *ultra vires* must be applied to the facts as they are found; that is, the facts must first be determined as to what contract the parties intended, and the defense of *ultra vires* must be applied to those facts. In the case at bar, the Supreme Court of Ohio, not disputing the facts as stated above, nor that the syndicate was a partnership, nor that the bank intended to become a partner therein, instead of applying the defense of *ultra vires* to these facts so found, used the defense of *ultra vires* to produce a result not contemplated by any of the parties and reaching a result unknown to the law. No reason is given by the Supreme Court of Ohio for its holding, that, since the plaintiff in error could not become a partner, the "legal effect" of the transaction was

to make it a part owner of real estate, and the result reached is directly contrary to the California Bank case, and directly contrary to all sound legal doctrine.

It is submitted, therefore, that if the plaintiff in error had no power, under the circumstances of this case, to take these shares as a partner, it could not become liable in any way for any part of the indebtedness of the partnership.

(*c*). That the plaintiff in error had no power, under the banking laws of the United States, to become a member of a partnership dealing in real estate, even for the purpose of securing a pre-existing indebtedness, is decided in the case of *The First National Bank of Ottawa* v. *Converse, Receiver*, decided by this court on February 19, 1906. This court there held that a bank, even to secure a pre-existing indebtedness, had no power to engage in a speculative enterprise. What was done by the bank in that case was much less than what was done by the plaintiff in error in this case. To take preferred stock in a corporation organized for the purpose of purchasing the assets of another corporation, and carrying on its business, is certainly much less speculative than to take an interest in a partnership dealing in real estate, and to thus open the door to an unlimited liability sufficient, in many cases, to ruin the strongest bank.

It is submitted, therefore—

First. That the whole question of the effect of the plaintiff in error's becoming the owner of these shares *de facto*, and of the effect of the defense of *ultra vires*, whether it renders the whole contract void, or whether it may form the basis for some consequential liability, is a federal question, according to the decision in *The California Bank* v. *Kennedy*.

Second. That if the plaintiff in error took these shares intending to be a partner, and to have an interest only in the net profits of the syndicate, and if the plaintiff in error had no power to take the shares in that way, no title to the shares passed to it at all, the whole transaction was void, and no liability of any sort can be imposed upon the plaintiff in error according to the decision in *The California Bank* v. *Kennedy.*

Third. That the plaintiff in error had no power, even to secure a pre-existing indebtedness, to take title to shares in a partnership dealing in land, or to make itself liable for any part of the indebtedness of such a partnership, according to the decision in *The First National Bank of Ottawa* v. *Converse, Receiver.*

Respectfully submitted,

W. C. HERRON,

Of Counsel for Plaintiff in Error.